



## DEBT SERVICE

INFRASTRUCTURE AND GENERAL GOVERNMENT APPROPRIATIONS SUBCOMMITTEE  
STAFF: STEVEN ALLRED, MARK BLEAZARD, AND GARY RICKS

## ISSUE BRIEF

**SUMMARY**

Debt service is made up of interest and principal due on the state's bonded indebtedness. The state often uses bonds to finance large capital expenditures, including new facility construction, major remodeling, and highway projects. General Obligation (G.O.) bonds are backed by the full faith and credit of the state. Revenue bonds are secured by dedicated revenue streams such as enterprise fund revenue or lease payments. Debt service on revenue bonds and G.O. bonds is combined in this line item.

**ISSUES AND RECOMMENDATIONS*****Outstanding G.O. Bonds***

The table to the right includes current outstanding G.O. bond indebtedness broken out by buildings and highways. It does not include \$105.9 million in bonds authorized by the Legislature but not yet issued.

***Can bonds be paid off early?***

The question often arises as to whether bonds can be paid off early. Almost every year at least one bond series is paid off as it reaches its normal maturity. Under the normal schedule, Utah will pay off two bonds (Series 2004B and 2007A) on July 1, 2014. Any bond can be legally defeased earlier than its final maturity date. Although a defeasance is generally accomplished by a refunding

transaction, a defeasance can also be accomplished with cash. Doing so would involve setting aside sufficient cash or U.S. Treasury obligations in an escrow account to meet all principal and interest payments on the outstanding bonds as they become due until their call date, at which point the escrow retires the remainder of the debt. However, the interest rate in the escrow account cannot exceed the interest rate on the bonds ("arbitrage") or the bonds can lose their federal authorization to be tax free to investors. With the historically low interest rates on Utah's bonds, defeasing them early may be an inefficient economic option.

***Utah's "Triple A" Rating***

The three nationally recognized bond rating agencies, Moody's, Standard and Poor's, and Fitch, provide ratings of credit worthiness of all states. As of 2013, nine states merit a "Triple A" rating from all three agencies: Alaska, Delaware, Georgia, Iowa, Maryland, Missouri, North Carolina, Utah, and Virginia.

**Outstanding GO Bond Indebtedness**

	<u>Series</u>	<u>Original Amount</u>	<u>Final Maturity Date</u>	<u>Outstanding as of Jan 1, 2014</u>
Capital Facility Projects	2009B	\$ 104,450,000	July 1, 2015	\$ 44,100,000
	2009C	\$ 126,780,000	July 1, 2015	\$ 51,045,000
	2010A	\$ 79,710,000	July 1, 2016	\$ 76,710,000
	2011	\$ 46,860,000	July 1, 2017	\$ 46,860,000
	2012A	\$ 33,240,000	July 1, 2017	\$ 33,240,000
Highway Projects	2004A*	\$ 314,775,000	July 1, 2016	\$ 204,910,000
	2004B	\$ 47,050,000	July 1, 2014	\$ 3,950,000
	2007A	\$ 68,995,000	July 1, 2014	\$ 11,215,000
	2009A	\$ 394,360,000	July 1, 2019	\$ 150,005,000
	2009C	\$ 363,630,000	July 1, 2018	\$ 302,105,000
	2009D	\$ 491,760,000	July 1, 2024	\$ 491,760,000
	2010A	\$ 333,280,000	July 1, 2017	\$ 191,000,000
	2010B	\$ 621,980,000	July 1, 2025	\$ 621,980,000
	2010C*	\$ 172,055,000	July 1, 2019	\$ 172,055,000
	2011	\$ 563,060,000	July 1, 2026	\$ 505,535,000
	2012A*	\$ 4,110,000	July 1, 2015	\$ 4,110,000
	2013	\$ 226,175,000	July 1, 2028	\$ 226,175,000
	* refunding			\$ 3,136,755,000

**Build America Bonds Subsidy**

Utah issued five bond series using the federal Build America Bonds (BAB) program (two G.O. issues and three revenue bond issues) which provided an IRS refund subsidy in return for selling taxable bonds at higher interest rates. The BAB program as originally programmed was estimated to save the State \$55 million over 15 years on \$1,114 million of G.O. bonds. About two years ago, bond rating agencies provided direction to issuers using the BAB program to budget debt service gross of federal subsidies. This direction indicated a certain level of risk with the BAB program. To comply, the State appropriated an additional \$15,252,400 from the General Fund to the Debt Service budget. The funds will be transferred back to the General Fund upon receipt of the refund.

However, recent changes to federal sequestration reduced the anticipated subsidy for the FY 2014 refund payments by \$1,098,200 or 7.2 percent of the original subsidy, thereby increasing the amount that will need to be transferred from the TIF and County funds to cover the BABs shortfall. Future changes in subsidies will be determined by Congress as it sets appropriations under federal spending caps, meaning it is unclear at the moment whether and how much additional sequestration will occur in the BABs program.

**Authorized Bonds Not Yet Issued**

The Analyst recommends the Legislature review two bond authorizations and consider rescinding them.

1. A G.O. bond authorized in S.B 298 (2008 G.S.) for \$42,500,000 for the St. George airport. The need for this authorization has lapsed and it is unlikely the bonds will be issued.
2. A lease-revenue bond authorized in S.B. 235 (2000 G.S.) for \$10,500,000 for a State Fairpark multipurpose building. This approval is now fourteen years old. The Analyst recommends the Fairpark management renew its request to the Legislature if they still desire to issue bonds.

**ACCOUNTABILITY*****Constitutional and Statutory Bonding Capacity***

The State's constitutional debt limit caps total general obligation debt at 1.5 percent of the value of the state's taxable property. The following information comes from the State's 2013 [Continuing Disclosure](#):

Fair market value of ad valorem taxable property.....	\$261,933,703,652
Fees in lieu of ad valorem taxable property.....	<u>11,020,102,658</u>
Total fair market value of taxable property .....	<u>\$272,953,806,310</u>
Constitutional debt limit (1.5%).....	\$4,094,307,095
Less: currently outstanding general obligation debt (net) .....	<u>(3,278,406,150)</u>
Estimated additional constitutional debt incurring capacity of the State.....	<u>\$815,900,945</u>

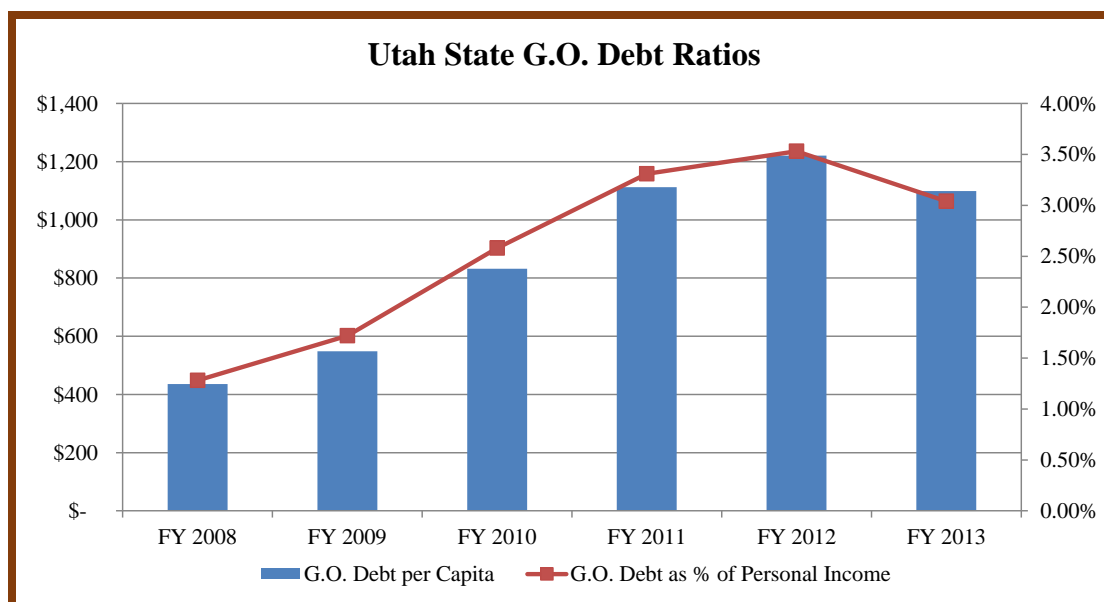
The State's statutory debt limit caps general obligation debt to 45 percent of the maximum allowable appropriations limit unless approved by more than two-thirds of the Legislature. However, statute excludes most highway bonds from being subject to the statutory debt limitation. The following information comes from the same Continuing Disclosure as referenced above:

The State Appropriations and Tax Limitation Act and additional general obligation debt incurring capacity of the State under that act are as of December 31, 2013, as follows:

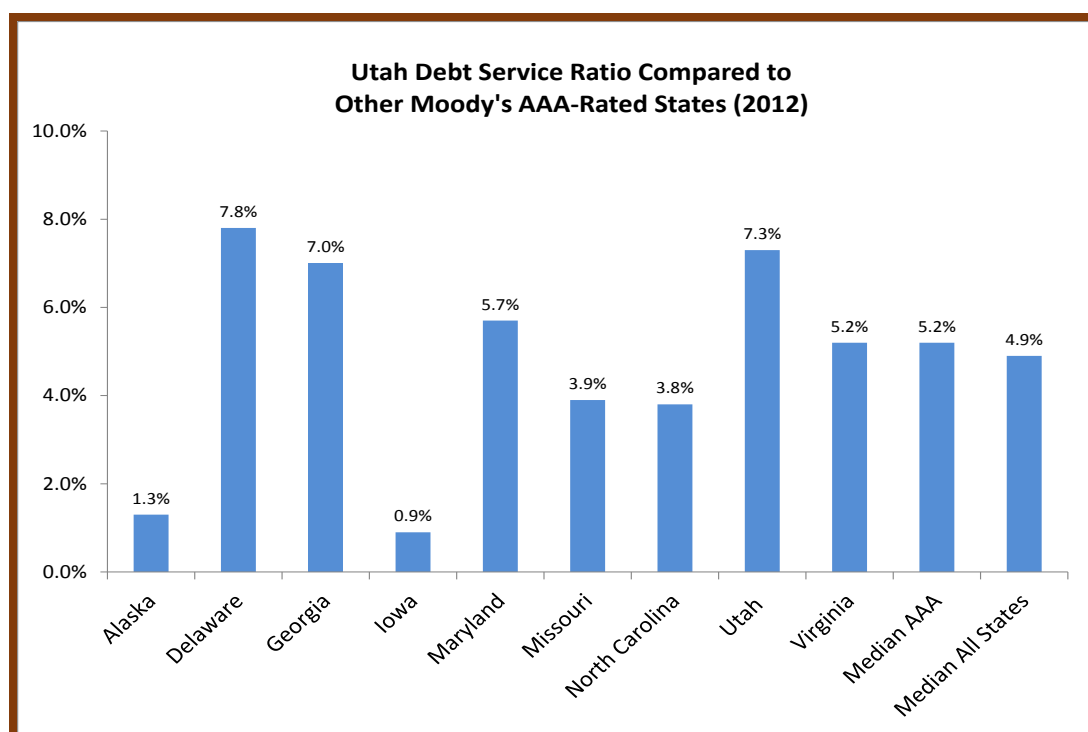
Statutory general obligation debt limit.....	\$1,490,771,225
Less: statutorily applicable general obligation debt (net) .....	<u>(414,858,625)</u>
Remaining statutory general obligation debt incurring capacity.....	<u>\$1,075,912,600</u>

### Debt Ratios

Rating agencies, as well as investors, look at a state's outstanding debt relative to population and personal income. These indicators give insight into a state's indebtedness and the debt burden placed on taxpayers. Per capita debt is calculated by dividing the total outstanding debt by the current population estimate. Debt as a percent of personal income is calculated by dividing current outstanding debt by a state's total personal income. The chart below shows a history of Utah's G.O. debt ratios.



The current estimate of the State's G.O. per capita debt is \$1,099 while Utah's debt as a percentage of personal income is currently 3.04%. Both are slight reductions from the peak in FY 2012 which resulted from increased bonding for highway projects including the reconstruction of I-15 in Utah County and the Critical Highway Needs program.



As of 2012 Utah had a debt service ratio (ratio of debt service to annual revenues) amongst the highest of the “AAA” rated states, and higher than the median of all states. When data for 2013 become available, Utah’s debt service ratio should show a slight decline from the 2012 peak.

### **BUDGET DETAIL**

The following table shows the base budget as well as changes necessary to meet debt service obligations. Such changes include the aforementioned BAB subsidy reduction. Recommended adjustments are summarized below the table.

Debt Service							
<u>Sources of Finance</u>	<u>2013 Actual</u>	<u>2014 Approp</u>	<u>2014 Change</u>	<u>2014 Estim</u>	<u>2015 Base</u>	<u>2015 Change</u>	<u>2015 Recomm</u>
General Fund	54,599,700	54,599,700	(42,600)	54,557,100	54,599,700	(126,600)	54,473,100
General Fund, One-time	15,252,400	15,252,400	(1,098,200)	14,154,200		14,154,200	14,154,200
Education Fund	17,164,300	17,164,300	64,300	17,228,600	17,164,300	37,700	17,202,000
TIF of 2005	332,808,600	333,204,000	10,452,600	343,656,600	333,204,000	(6,752,000)	326,452,000
Federal Funds	16,260,400	16,999,900	(1,224,000)	15,775,900	16,999,900	(1,224,000)	15,775,900
Dedicated Credits	22,231,500	22,955,000	(228,600)	22,726,400	22,955,000	2,134,100	25,089,100
County of 1st Class	22,100,800	24,614,700	24,300	24,639,000	24,614,700	(8,116,100)	16,498,600
Transfers	(15,252,400)	(15,252,400)	1,098,200	(14,154,200)		(14,154,200)	(14,154,200)
Transfers (2014)			(1,051,400)	(1,051,400)			
Beginning Nonlapsing	6,149,000	2,679,200	5,750,100	8,429,300	2,679,200	4,677,100	7,356,300
Closing Nonlapsing	(8,429,300)	(755,500)	(6,600,800)	(7,356,300)	(755,500)	(6,689,600)	(7,445,100)
<b>Total</b>	<b>462,885,000</b>	<b>471,461,300</b>	<b>7,143,900</b>	<b>478,605,200</b>	<b>471,461,300</b>	<b>(16,059,400)</b>	<b>455,401,900</b>

### **LEGISLATIVE ACTION**

The Analyst recommends the Legislature approve the following changes to the Debt Service budget for FY 2014 and FY 2015 (see “Change” columns in the table).

#### **FY 2014**

1. Reduce the General Fund ongoing by \$42,600 as a result of a reduction in bond payments due from the General Fund.
2. Reduce the General Fund, One-time appropriation by \$1,098,200. This appropriation is returned to the General Fund at the end of each fiscal year. Because of a reduction in federal BAB subsidy, the amount to appropriate from the General Fund, and then return to the General Fund at the end of the year, should be reduced by the same amount as the federal funds loss.
3. Increase the Education Fund appropriation by \$64,300 as a result of increased bond payments due from the Education Fund (higher education buildings).
4. Increase the TIF of 2005 appropriation by \$10,452,600 for increased bond payments due from the TIF (highway projects). Part of this is to cover the loss of federal subsidy.
5. Decrease federal funds by \$1,224,000 as a loss of federal subsidy to G.O. bonds and lease-revenue bonds under the BAB program.
6. Decrease Dedicated Credits by \$228,600 as a result of changes in lease revenue bond payments.
7. Increase the County of 1<sup>st</sup> Class Fund appropriation by \$24,300 to increased bond payments due from that source.
8. Change the Transfers appropriation by \$1,098,200 to match the change described in item #2.

9. Transfer \$1,051,400 out of the Debt Service line item as a result of bonds being paid off. Transfers should go to:
  - a. \$975,300 to the General Fund.
  - b. \$76,000 to the Departments of Human Services and Workforce Services for bonds that have been paid off (a portion of which was federal money).
10. The Analyst recommends the following intent language be included in the FY 2014 supplemental appropriations act:

*The Legislature intends that in the event that sequestration or other federal action reduces the anticipated Build America Bond subsidy payments that are deposited into the Debt Service line item as federal funds, the Division of Finance, acting on behalf of the State Board of Bonding Commissioners, shall reduce the appropriated transfer from Nonlapsing Balances – Debt Service to the General Fund, One-time proportionally to the reduction in subsidy payment received, thus holding the Debt Service fund harmless.*

#### **FY 2015**

1. Reduce the General Fund ongoing by \$126,600 as a result of a reduction in bond payments due from the General Fund.
2. Add \$14,154,200 from the General Fund, One-time as the amount of General Fund remaining to cover the BAB subsidy risk, and which will be transferred to the General Fund at the end of the fiscal year.
3. Increase the Education Fund appropriation by \$37,700 as a result of increased bond payments due from the Education Fund (higher education buildings).
4. Decrease the TIF of 2005 appropriation by \$6,752,200 for reduced bond payments due from the TIF (highway projects).
5. Decrease federal funds by \$1,224,000 as a loss of federal subsidy to G.O. bonds and lease-revenue bonds under the BAB program.
6. Increase Dedicated Credits by \$2,134,100 as a result in an increase in revenue bond payments.
7. Decrease the County of 1<sup>st</sup> Class Fund appropriation by \$8,116,100 as a result in a reduction in bond payments.
8. Change the Transfers appropriation by \$14,154,200 to match the change described in item #2.